A Banker Looks at the Examination Process

Excerpts from a talk given by Donald C. Platten, *Chairman, Chemical Bank, before a group of Federal Reserve Bank of New York examiners on January 23, 1979. His remarks should be of wide interest to bankers.*

When I entered the banking business thirty-seven years ago, there was a common saying that "Nobody loves his banker". That statement wasn't entirely true even then, but there was some truth in it. A corollary was that a banker was not exactly overjoyed to see the examiners on his doorstep.

The stereotype of a banker then was a flinty-faced naysayer, who asked embarrassing questions and then didn't believe the answers. The stereotype of a bank examiner was a nitpicker in a green eyeshade who was at best a nuisance, and at worst a threat. Neither stereotype is valid in today's complex, changing world.

Considering the pace of change in our industry over the last ten years, it is fair to say that banks and their examiners have been undergoing what could be called a "shared revolution". As I reflect on the many changes that have taken place, it occurs to me that one of the most important has been a crucial shift in the relationship between the bank and its regulators. More than ever before the regulator and the regulated are what might be called "friendly adversaries", each with a common interest in seeing the job well done, even though they approach it from differing viewpoints.

As the banking industry has become increasingly diversified and far-flung, and as the challenge of managing it grows in geometric scale, the burden falls ever more heavily on our internal systems, on our external auditors, and most certainly on the examiners. They must check and double-check procedures and controls. They must alert us to danger signals and let us know where we have blundered, as we sometimes do.

Because of this rising challenge to the examination process, I am very encouraged by the innovations I see taking place in bank examination methods today. Developments such as the Shared National Credit Program, Uniform Country Risk Evaluation, and the Uniform Interagency Bank Rating System are altogether constructive and bound to save wasted motion on both sides.

Perhaps the most promising innovation of all is the recent focus on the "top-down" approach to bank examination. This approach is not only cost effective, in terms of both money and manpower, but also represents a form of "preventive medicine". A careful evaluation of systems and controls *before* trouble occurs is the best method of preventing trouble. Moreover, a "systems" approach such as this will be increasingly necessary, for banks and regulators alike, if we hope to maintain effective control of far-flung, complex, and diverse operations.

The expansion of United States banks overseas means an increasingly widespread physical organization. These banks, operating in varying cultures, employing growing numbers of foreign nationals, will have a growing need to evaluate political and economic risks as well as the managements of foreign companies whose disclosure standards do not match our own. At the same time, as banks become more heavily involved in activities such as foreign exchange trading, where risks are very high within a short time span, there will be a much-heightened demand for tough, tight, and sensitive controls.

If the barriers to interstate branching are lifted soon —as many competent authorities predict—dozens of banks will be expanding, perhaps too rapidly, into unfamiliar territory. It seems certain this expansion will change competitive relationships and market shares The pressures and temptations will be great and, perhaps, push some managements and control systems to the limit—or beyond

At present, our entire society is going through a revolution not only in its regulatory apparatus, but in the whole relationship of the people to their government It isn't a very orderly revolution. In some areas there has been deregulation or streamlining of existing regulation. Witness the very promising deregulation of airline fares. But there have also been too many cases of clumsy or unworkable new regulations.

Proposition 13 in California, and the events related to it, reflect the public's ambivalence toward the role of government in their lives. The people have made it clear that they want their taxes cut. At the same time, they want public services *increased* in areas such as education and health. But this contradiction is only on the surface. According to opinion analysts, what the people really want from government is *excellence.*

And that, of couse, is what both sides want in bank regulation—excellence, relevance, realism of the rules. But, however much the regulation of banks may improve and adapt to changing realities, and no matter how much both sides may share a commitment to, and a desire for, excellence we will remain, and we *should* remain, "friendly adversaries", each with our separate priorities and points of view.

An ancient Greek philosopher once spoke of what he called "the harmony of tension" in an adversary relationship I think that expresses it very well. I hope these remarks will serve to increase the harmony between banks and examiners without entirely removing that necessary tension.